ROUTLEDGE STUDIES IN THE MODERN WORLD ECONOMY

Capitalism and the World Economy

The light and shadow of globalization

Edited by
Toshiaki Hirai

ROUTLEDGE

Capitalism and the World Economy

Globalization is a phenomenon that has attracted much attention in the past, but there are still many questions that remain unanswered.

This book categorizes globalization into three types: financial globalization; the collapse of the Cold War order and the ensuing convergence toward the capitalistic system; and the rise of the emerging nations. The globalization of capitalism has two implications. One is trust in the market economy system and support for a minimal state while another is an aspect of the Casino Capitalism as typically seen by the rampant emergence of hedge funds.

This book explores both the light and shadow cast by globalization, endeavoring to identify both positive and problematic effects of the globalization process on the world economy. For this purpose we first examine the nature and the features of world capitalism in relation to globalization. Then we discuss and investigate the path along which important nations—first the developed nations (the USA, EU and Japan), followed by the emerging nations (BRICs)—have proceeded under the influence of globalization.

This collection, from a selection of leading international contributors, will not only shed light on world capitalism as it is now, but will also offer pointers as to its future directions.

Toshiaki Hirai is Emeritus Professor at Sophia University, Tokyo.

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Preface

1 The aim of this book

The aim of this book is to identify what globalization has brought about over the last three decades, examine how world capitalism has evolved and changed through globalization, and evaluate globalization (focusing on its light and shadow) through representative nations—both developed and emerging nations.

Focusing on this phenomenon from diverse points of view should prove fruitful for an understanding not only of world capitalism as it is but also of the direction in which it will be moving.

A word about the general design of this book might be helpful for readers approaching it. What follows is entirely attributable to the editor, although we have discussed it together (further details are elucidated in Chapter 1).

Since the mid-1980s the world economy has seen the evolution of globalization, which can be characterized as the "phenomenon moving toward a market economy on a global scale."

Globalization can be considered from two viewpoints—the factors that favored it and the phenomena that occurred as a result of those factors.

With regard to the factors, we will single out the following five:

1 neoliberalism;
2 financial liberalization;
3 liberalization of capital transaction;
4 New Industrial Revolution; and
5 the collapse of the socialistic system.

More in detail, (1) is the fruit of developments in thought in the broad sense, (2) and (3) are steps intentionally taken by governments and financial institutions in the direction of financial liberalization, (4) is a conquest of the IT revolution, initiated by many young US entrepreneurs, and (5) is the collapse of a rival to the capitalistic system, for a number of reasons.

As for the phenomena, four types of globalization could be identified as constituting the great transformation of the world economic system:

1 Financial Globalization;
2 Market System I—Globalization, with the collapse of the Cold War order and the ensuing convergence toward the capitalistic system;
3 Market System II—Globalization, with the rise of the emerging nations—the so-called BRICs; and
4 Globalization of Market Integration—the EU (or the euro system).

Globalization, in a nutshell, has offered great opportunities for the emerging nations to attain high rates of economic growth—so high, indeed, as to qualify them for membership of the G20 (although Russia suffered severely from the so-called Shock Therapy). For the US and the UK, globalization has contributed to their regaining economic power from Japan, especially through financial globalization. Financial globalization, on the other hand, has proved so excessive as to make the world economy increasingly fragile and unstable.

We cannot and need not prevent the advent of globalization. But we need to know what capitalism is and how it should be managed in order to prevent excesses, especially in financial globalization.

2 Contents explained

The book is composed of three parts.

Part I, "Bird's-eye view," addresses the following problems broadly and theoretically: What is globalization? How should we evaluate it in relation to world capitalism?

Chapter 1 explores the light and shadow of globalization in a broad perspective, serving as a general introduction to the whole book. Chapter 2 examines how financial globalization has made the world economy increasingly unstable and volatile in the course of time, focusing on the Dodd–Frank Act (July 2010) and its implementation in the US. Chapter 3 offers a qualified analysis of the recent global economic disorder and sheds light on Keynes's legacy in terms of international economic relations. Chapter 4 explains how openness to world trade and investment has fostered both faster growth and greater income equality between and within countries in terms of dynamic comparative advantage.

Part II, "Developed nations—USA, EU and Japan" examines how the developed nations have been affected by globalization.

Chapter 5 states, based on a Minskian approach, that when markets do not work to promote the public interest, a system of constraints and interventions can work better, and we need to make "industry" dominate over "speculation" for meeting the crisis.

Chapter 6 insists that the European crisis is mainly due to the tendency of the traditional market toward saturation. This is not sufficiently counteracted—neither with the new inventions nor with great development projects supported by the state. Chapter 7 maintains that the institutional and structural flaws of the "eurosystem" are still there in spite of the European Central Bank's policy, and the crisis in the real economies, facing austerity measures, appears to be getting worse.

Chapter 8 seeks to explore the extent to which British developments reflected a return to Keynesian doctrines in the conduct of public policy—Britain which, as from 2008, embraced fiscal policy after the prolonged reaction against Keynesianism.

Chapter 9 argues that Japan's ratio of exports and imports to GDP showed practically no increase in 1990s, while other countries' ratios increased significantly. Why did de-globalization come about in Japan? Chapter 10 examines the trade friction that existed between the US and Japan during the 1980s and the 1990s and the associated economic policies that contributed to this friction, with a deep-rooted misguided belief.

Part III, "Emerging nations—BRICs," deals with how they have been able to exploit globalization and achieve high rates of economic growth, to the extent of taking on increasingly important roles in the world economy.

Chapter 11 examines how, in Brazil, globalization constrained policy decision-making in the period, including the definition of growth policies, and what the result of the process was in terms of economic growth. Chapter 12, following Karl Polanyi's theory, examines the four stages of a sequence in the Indian economy: economic reforms and liberalization; impact on economy with regressive consequences; resistance by people-centered organizations; and limited measures by the state.

Chapter 13 turns the focus towards China. It has greatly benefited from globalization, attaining high economic growth through trade and foreign direct investment. However, this has also caused growing disparity. Thus globalization has produced a mixed effect on China. Chapter 14 examines the effect of globalization on the development of the corporate sector in Russia, focusing on its mixed impact on the rise and functioning of Russia's major natural resource corporations.

3 How did this project emerge?

The present project originated with a project funded by Sophia University (2009–2012). The findings of these three years' activities, including the international symposia at the University of Graz (Austria, January 2010) and Sophia University (Japan, October 2010), were submitted to the Repository [Sophia-R] in August 2012.

Then an idea emerged: why not concentrate our focus on the present globalization and continue our study? We then worked out how to organize a new project, the findings of which are presented here.

We wish to express our gratitude to the collaborators on the former project (Prof. Linda Grove [Sophia University], and Prof. Noriko Hataya [Sophia University]) as well as Sophia University for providing funds, and the University of Graz for holding a superb conference (thanks to Prof. Heinz Kurz [University of Graz]).

We have organized this project in the belief that globalization is an important object of study in the social sciences and in understanding the present world. We will have fulfilled our ambition if readers are able to gain some insight into the light and shadow of globalization and world capitalism.

Tokyo, May 2014

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Part I

Bird's-eye view

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1 Capitalism and globalization

Toshiaki Hirai

1 Introduction

This chapter aims to address the following themes fairly broadly and theoretically, reflecting a general perspective on the whole book: What is the present state of globalization? How should we evaluate it in relation to capitalism?

If we try to characterize the development of the world economy from the latter half of the 1980s to the present day with a single word, there could be none more appropriate than "globalization," which may be defined as the "phenomenon moving toward market economy (or capitalism) on a global scale."

We may then go on to single out three points to characterize the present state of globalization: (1) As a principle of operating the economy, capitalism has been globally adopted, while socialism has been abandoned; (2) financial globalization has developed to an extreme degree; and (3) several countries that had been regarded as developing countries have attained remarkable economic growth, to such a degree that they have come to occupy an important role in the world economy. (1) is an epoch-making phenomenon in the postwar world economy, never before seen on the worldwide scale, although it found a place in the Pax Britannica. (2) is remarkable in terms of scale and the multiplicity of financial products. (3) is a new phenomenon that is throwing the North–South dichotomy awry.

This chapter runs as follows. First, we look into the nature of capitalism, for the present globalization constitutes a development of it. Here the essential characteristics of the capitalistic system are pointed out, followed by its problematics.

Second, globalization is examined. It can be approached from two sides—five factors which caused it, and four types of globalization which occurred as a result.

The five factors are: (1) neoliberalism; (2) financial liberalization; (3) liberalization of capital transactions; (4) the New Industrial Revolution; and (5) the collapse of socialistic systems. The four types of globalization lie in: (1) financial globalization; (2) capitalism in the ex-communist bloc; (3) the emerging countries; and (4) the EU. An important point is that globalization can be classified under the broad headings of financial globalization (1) and market system globalization, which includes (2), (3) and (4). The salient tendency has been for the former to promote the latter; while bringing about a huge glut of financial capital, the former has left the world economy more fragile.

2 The capitalistic system

2.1 Essentials

We may mention six points worth noting as essentials of capitalism: (1) dynamics, (2) markets, (3) capital, (4) firms, (5) uncertainty, (6) ambiguities. The first four are connected with the strong points in a capitalistic system, the last two with the weak points.

1. Dynamics—The essential nature of a capitalistic system is embodiment of an impulse toward growth. A capitalistic system generates increase in production and growth through the development of division of labor, competition and technology while it plows down the existing systems. Thus the capitalistic system is a dynamic system which also embodies instability. Its “dynamics” operates through “markets” and “capital.”
2. Markets—They have two salient characteristics: (a) that of “turning everything into commodities” and (b) “the monetary economy.”
   a. A capitalistic society might even be summed up as a society in which the most important elements of the economy come to be transacted, being turned into commodities. These include not only labor but also, in recent years, securitized products, the emission trading system, etc.
   b. In the markets, almost all the transactions are carried out by means of money. That is, in a capitalistic society barter is not an essential form of transaction.
3. Capital—Capital, which is divided broadly into “real capital” and “finance capital,” is an important wheel which sets markets in motion. Finance capital, among other things, keeping a lookout over all the markets on the globe, enters those deemed most profitable, making some markets active, others inactive. Firms and industries that cannot procure finance capital face grim prospects. As a result, the industrial structure undergoes sweeping transformation and the capitalistic system sees growth.
4. Firms—Firms play an absolutely vital role in “dynamics” of capitalism. They must develop, looking to the uncertain future, new goods and new markets, injecting huge amounts of capital and human resources.

The above-mentioned four features are strong points. Through a gigantic network of markets, economic activities are developed and economic agents are allowed to behave on a self-driven basis. Through the mechanism of numerous markets a great many economic agents produce and exchange vast quantities of goods and services. Moreover, through the activities of firms the economy as a whole can enjoy dynamic development.

The capitalistic system operates through the activities of economic agents who are free to choose their rational behaviors, bringing about desirable results from the point of view of economic efficiency. It is superior to socialistic systems in terms of freedom, for it is through the markets—to a great extent "autonomous," not depending on decrees by some particular persons—that the production and exchange of goods and services are carried out.

In contrast with the above (1)–(4), the following show the capitalistic system as subject to various uncertainties and ambiguities.

5 Uncertainties—the capitalistic system faces various kinds of uncertainties. Firms need to go on producing goods forecasting sales in the markets. They need to make great efforts to develop new goods. Once they succeed in doing so, they need to build capital equipment, seeking to boost profits. And yet forecasting is a very difficult art because the sales of the goods depend on demand.

Moreover, present-day capitalism has tended to get involved in "self-augmentation of finance capital," so that firms in the real economy are forced to produce and sell goods while coping with the behavior of finance capital, which makes forecasting more difficult.

6 Ambiguities—Economics has assumed "rationality" in regard to markets and economic agents and maintained that the unfettered market system can bring about the Pareto optimum. To some extent, this system has superior features in that independent individuals can make their own decisions in the market, and many goods and services are determined without any intentional interference from outside.

This assumption, however, entails big problems. It relies excessively on "rationality." If the capitalistic system was conceived exclusively in terms of rationality, cognitive errors would be inevitable. One example lies in the "ambiguities" characterizing capitalism, as distinct from uncertainties. We will illustrate this point with three cases.[1]

Market price: Economics teaches us that the relative price is determined at the intersection between demand and supply in each market, regarding money as a veil. However, it should be an absolute price which is actually determined at the intersection, with money always working as a counterparty. This has important consequences, quite different from barter transactions.

Suppose that a certain good has enjoyed extremely high sales due to, say, word of mouth or advertising. The absolute price goes up and the firms concerned can make a huge profit. In this situation financial institutions can enter this market, creating money. As this phenomenon encroaches on the goods concerned, the possibility looms up that the price as determined by demand and supply is not the result of optimal behaviors of economic agents. Could the market mechanism, greatly influenced as it is by credit creation, really determine a "fair" price? We need to keep an eye on the market, with some idea of fairness in mind.

Accounting: The amount of profit a firm can make depends entirely on the accounting system, for complicated everyday business activities cannot provide it with concrete information. Thus every transaction is kept on a balance sheet. And once or twice a year a firm makes performance public in the form of the balance sheet and the earnings statement.

However, this system has a shortcoming. Among other things, depreciation allowance and inflation/deflation are serious matters. Depreciation allowance is not exempt from some degree of arbitrariness. Inflation/deflation is more serious, for if it went to extremes, accounting would lose its significance. The figures thus kept for, say, half a year, show a bias and do not convey correct information, and yet firms have no other choice. In this case, nominal GDP does not constitute correct information. In order to avoid the problem, social accounting calculates real GDP by dividing it by the GDP deflator, although even this method cannot prevent the essential ambiguity.[2]

Debt contract: In a capitalistic system various kinds of debt contracts are made, using money as unit of account. In this case, debts cannot avoid the influence of inflation/deflation, and yet people cannot help but enter upon debt contracts based on money as unit of account. In spite of the fact that in a capitalistic system contracts in terms of money are absolutely fundamental, "ambiguities" always crop up there.

2.2 Issues involved

We saw in section 2.1 that a capitalistic system, in principle, has strong points in terms of "dynamism," "market," "capital," and "firms" while it has weak points in terms of "uncertainties" and "ambiguities." In this section we will see three issues—(1) the bubble phenomenon; (2) corruption and injustice; and (3) the disparity problem—as constituting headaches for the system, which are, more or less, related to the weak points.

2.2.1 The bubble phenomenon

Reference here is to a situation in which the economy overheats due to some factor, to such a degree that the government tries in vain to control it, finally leading to the bubble bursting. These phenomena have occurred repeatedly over the centuries (e.g., the Tulip Bubble and the Stock Bubble associated with John Law).

In economics, however, the bubble phenomenon has been dealt with as an exceptional case. The principal task of economics has resided, rather, in analyzing normal processes. Most economists placed profound trust in the "classical dichotomy" and "Say's Law," thereby failing to address an issue like unemployment in a capitalistic society until Keynes appeared on the scene.

The trend in these last two decades has been to revert to the tenets prior to Keynes. The new classical macroeconomics has defended the "classical dichotomy" and Say's Law, and yet it allowed for economic fluctuations. Worse still, this has become the mainstream.

Strangely enough, these two decades have seen increase in the degree of instability of the capitalistic system with repeated bubble phenomena—e.g., the Japanese bubble and its burst from the end of the 1980s to the early 1990s, the US dot.com bubble and its burst from the mid-1990s to 2000, and the housing and subprime bubble and its burst in the early 2000s, all of which occurred due to speculative activities with an abnormal bloat of money. Moreover, our modern-day governments have been unable to prevent these bubbles from reaching a bursting point. The reason why the bubble is a serious issue for the economic system is that it could drive people excessively into money-making activities. When rival firms are making huge profits on a bubble, the CEO of any particular company will not be allowed to sit and wait, stating that the bubble will burst soon. Employees are put in a similar position. This sort of climate comes from human nature itself, underlying society—people cannot sit and wait while rivals are making profits.

Human beings are consciously or potentially driven by the desire to obtain wealth and fortune. Once the bubble occurs, increasing numbers of people grow eager to pursue profit—even those who had hitherto been composed—and sooner or later join in, driven by such an instinct. As a result, the economy eventually plunges into the engulfing foam of the bubble, the real economy being neglected.

Thus the responsibility to prevent bubbles should be taken on by governments, and yet repeatedly we see them incapable of containing the burgeoning bubble. This is indicative of a malfunction of the capitalistic system and the respective system of government, thus constituting a problem we need to diagnose, and so reform the structure.

2.2.2 Corruption and injustice

When the excellence of the capitalistic system is evoked, free exchanges among agencies in the market are argued to be efficient and reasonable, with freedom and fairness being guaranteed.

Compared with a socialistic system, this is true, and yet this system has a weak point—corruption and injustice.[3]

Mainstream classical and neoclassical economics take the classical dichotomy for granted. They analyze the real economy in terms of relative prices, and then take money as determining absolute prices. However, this method is a static and non-monetary approach to the actual economy. Let us focus on the "monetary" aspect here.

Capitalism is a system which is inconceivable without money. As the real economy grows, the degree to which it depends on outside capital for production and service activities grows larger. Finance has its own existence value, for it enables smooth growth of the real economy. At the same time, however, finance is a sphere in which there is ample room for fraudulence. When finance enjoys unlimited freedom, the room for fraud grows disproportionately large. Today's world has been witnessing the money game conducted by means of "securitized products" together with the technique of "leverage" on a global level. These activities, unless some regulations are imposed, tend toward excessive speculation wrapped with a veil, and the scope for fraudulence is vast.

There are several types of corruption as well as dishonesty on the part of the financial institutions.

Forced saving: This is a behavior of financial institutions that buy goods ahead of the public with money they create. As a result, the amount of goods left for the public decreases proportionately. Thus the public is forced to save. This shows that they can procure money and get whatever goods they want at will. The market system could thus be misappropriated.

Stock market malpractice: The stock market is a market representing the capitalistic system. It is an important means by which firms can procure the money they require. And yet it is a place that enables many wrongdoings. From illegal operations to suspicious borderline dealing, including insider trading, stock price manipulations by means of disinformation and so forth by means of which unjustifiable profits are obtained.

Way of usurping profits through non-existence, or opacity of markets: We can in many cases point out the transparency of capitalism as a strength. In the financial markets, however, this virtue may be lacking.

In recent years "securitized products" have multiplied at an amazing rate, but many have been transacted in a disturbingly opaque way, without markets. Moreover, hedge funds, which have played a major role here, have not been subject to oversight by any governmental organization. The financial institutions have had a tendency to emphasize the importance of independence. However, the funds have carried out operations with huge amounts of money, to such an extent as to endanger the world economy, as exemplified by the LTCM in 1998. The runaway effect in the form of "market non-existence" and "opacity" of the financial system threatens to disintegrate capitalism.

2.2.3 The disparity problem

Capitalism bases the foundations of economic activities on the markets. Economists seeking to work out its mechanism have placed their trust in the general equilibrium theory. However, there is one point which is left out—distribution of income and/or wealth.

Moreover, in economics there is a proposition to the effect that "perfect competition brings about Pareto optimality." We are not told at which point on the so-called contract curve the exchange will be determined.

Mainstream economics interprets "justice" in terms of "commutative justice." This is an idea that the market mechanism attains "justice" through exchange behavior. It precludes value judgment of the state of distribution of stock—"distributive justice" is excluded.

When economists applaud market efficiency, they tend to emphasize an equality in the premise. This is also problematic, for in a capitalistic system there is no "equality in the premise." There exists the conviction that, left to the free